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TRANSITION TO A SINGLE CURRENCY SYSTEM

Note by the Secretariat

Provides information concerning recent actions and developments with respect to the introduction of a single currency system based on the euro, in compliance with decision IDB.26/Dec.6.

Background

1. The Secretariat has kept the governing bodies regularly informed of the steps taken to introduce the euro as a single currency for budgeting, assessment, accounting and reporting with effect from fiscal period 2002-2003. The most recent document on this subject (IDB.26/4-PBC.18/5 dated 19 June 2002) provided information on the following major items:

- Amendment of the relevant financial regulations relating to the preparation of budgets, appropriation and assessment, collection of contributions and advances, and currency of accounts;
- Establishment of a reserve for the purpose of protecting the Organization from exchange rate fluctuations;
- Exchange rates for conversion of both the dollar and schilling components of the budgets;
- Exchange rate to be applied for the conversion into euros of assets, liabilities, reserves and fund balances, as well as the need to continue to keep extrabudgetary accounts in United States dollars, if required, and to convert all such assets, liabilities, reserves and fund balances to euros for the purpose of UNIDO's consolidated financial statements;
- Actions and developments since 15 June 1999, to implement decisions of the governing bodies to introduce the euro;
- Issues encountered.

2. The Board at its twenty-sixth session took note of the information provided in document IDB.26/4-PBC.18/5 and noted with satisfaction that the Director-General had begun to take steps towards the full implementation of the single currency system based on the euro. Furthermore, the Board requested the Director-General to find solutions to the problems in

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implementation identified in the document and to keep Member States regularly informed of further developments (IDB.26/Dec.6).

I. EXPERIENCE AND ACTION TAKEN

3. As stated in document IDB.26/4-PBC.18/5, the Secretariat expected the emergence of a clearer picture on the issues encountered and the actions required to rectify these during the preparation of the accounts for the year 2002 and the biennium 2002-2003. The interim financial performance report for the biennium 2002-2003 showing the utilization of financial resources during the period 1 January to 31 December 2002 (IDB.27/8-PBC.19/8) has been finalized; it provides information on the regular and operational budgets as well as the technical cooperation activities financed from extrabudgetary resources. The slight delay in submitting the accounts to the External Auditor—required by 31 March in accordance with financial regulation 10.7—and consequently the issuance of the interim financial performance report and of the present document is mainly attributed to the following: a number of issues faced during the accounts closure process, particularly related to technical cooperation activities, required considerable analysis to assess the implications of various solutions and the need to adopt the most prudent approach; the preparation of a number of additional tables to provide information for technical cooperation activities in both euros and dollars; the need to provide information on the special accounts for the Regular Programme of Technical Cooperation and Buildings Management Services; and the preparation of detailed notes on changes in significant accounting policies explaining various actions taken by the Secretariat. It is expected that further refinements will be made during the preparation of the financial performance report for the biennium 2002-2003. The experience gained to date and the actions taken are indicated below.

Regular and operational budgets

4. The single currency system based on the currency in which most of the regular and operational budgets are implemented has allowed for, inter alia: the minimization of income- and expenditure-related exchange gains/losses; substantially reduced gains/losses resulting from the revaluation of assets, liabilities, reserves and fund balances at the date of the statement; better expenditure planning and monitoring of the utilization of resources; simplified and more accurate accounting and reporting relating to assessed contributions; easier comparison between the budgets and actual expenditures, thus improving budgetary controls.

Reducing dollar requirements for the regular budget

5. As stated in document IDB.26/4-PBC.18/5, it is not possible to completely eliminate the Organization's dollar requirements, which amounted to some 18 per cent of the expenditures in previous bienniums. The Secretariat has been striving to reduce its dollar requirements, and with the actions taken, as listed in document IDB.26/4-PBC.18/5, the Secretariat is moving towards achieving this objective during the biennium 2002-2003. However, substantial progress in this respect can only be achieved by the introduction of a United Nations system-wide solution, particularly relating to the issuance of salary scales for Professional and higher categories of staff as well as related payments to the United Nations Joint Staff Pension Fund in euros. UNIDO has been raising this issue at the Human Resource Directors Network, a subsidiary of the Chief Executives Board for Coordination (CEB). It is expected that this issue will gain more prominence with the introduction of the euro in other United Nations system organizations.

Reserve to protect UNIDO from exchange rate fluctuations

6. Recognizing the Organization's need for dollars to meet its obligations and for the purpose of protecting the Organization from exchange rate fluctuations arising from meeting such dollar requirements, the General Conference authorized the establishment of a reserve (GC.8/Dec.16). However, no funds for this purpose have been provided; the reserve had a zero opening balance at the beginning of 2002. This reserve is not subject to financial regulations 4.2(b) and 4.2(c); thus the balance, if any, available in the reserve will not form part of the unencumbered balances of the appropriations.

7. The dollar requirements for the biennium 2002-2003 were calculated using the January to December 2000 average United Nations euro/dollar exchange rate, i.e. €1=$0.925754 (reference IDB.24/3-PBC.17/3), or $1 = €1.0802006. In view of a stronger euro during the second half of 2002 and a similar outlook for 2003, it is expected that the reserve will receive a credit during 2003. The amount that would be transferred to the reserve would be the difference between the euro value of actual dollars expended to carry out activities under the regular budget and the budgeted cost of these dollars. This is illustrated by the following: for actual expenditures amounting to $10 million, the amount transferred to the reserve would be €77,006 calculated as:

- €10,725,000 Euro value of the dollars expended ($10 million x €1.0725, the average United Nations euro/dollar exchange rate for 2002)

- €10,802,006 Budgeted cost of the dollars expended ($10.0 million x €1.0802006, the budgeted United Nations euro/dollar exchange rate)

However, as stated above, no amount has thus far been transferred to the reserve. An adjustment for the biennium 2002-2003 will be made in December 2003.

Technical cooperation activities

8. As stated in document IDB.26/4-PBC.18/5, most extrabudgetary technical cooperation activities continue to be in dollars for which donors require accounting and reporting in dollars without being exposed to exchange gains/losses resulting from the introduction of the euro. However, activities funded from within the euro zone are expected to be carried out in euros. This means that the entire project cycle management (such as the issuance of project allotment documents, obligations, disbursement, accounting, monitoring and reporting) for technical cooperation activities would have to be performed simultaneously in United States dollars and euros. The next release of the financial software used by UNIDO, which is now expected to be implemented during the second half of 2003, should allow UNIDO to manage the project cycle in both United States dollars and euros with effect from January 2004.

9. During 2002, all technical cooperation activities were administered in dollars, whereas the regular and operational budgets were managed in euros. Donor statements are also being issued in dollars only. This practice will continue during 2003. To present the consolidated financial statements of UNIDO for the year ending 2002, the following actions were taken (details are contained in document IDB.27/8-PBC.19/8, which includes the notes to the financial statements):

- Combined statement of income and expenditure and changes in reserves and fund balances for the year ended 31 December 2002 (notes to the financial statements—annex II, table 1) has been prepared in both euros and dollars;

- Combined statement of assets, liabilities, and reserve and fund balances as at 31 December 2002 (notes to the financial statements—annex II, table 2) has been prepared in both euros and dollars;

- For the above statements, all non-euro items were converted to euros using the following approach:

  - The reserves and fund balances at the beginning of 2002, which were in dollars, were converted to euros at the exchange rate of US$1= €1.123 (GC.9/Dec.15);

  - Income, expenditure and changes in reserves and fund balances have been stated at the equivalent amount of euros applicable as at the deemed date of the transaction applying the United Nations operational rate of exchange as at that date, i.e. the applicable monthly exchange rates;

  - Assets, liabilities, reserves and fund balances as at 31 December 2002 have been revalued to euros using the United Nations operational rate of exchange as at 31 December 2002 (in accordance with decision GC.9/Dec.15).

- The loss arising from the revaluation of assets, liabilities, reserves and fund balances as at 31 December 2002 has been shown as "other adjustments to reserves and fund balances" on the euro combined statement of income and expenditure and changes in reserves and fund balances (notes to the financial statements—annex II, table 1 of document IDB.27/8-PBC.19/8). These adjustments/revaluations have no implications as far as the donors are concerned, as the dollar statements provide the correct information about the status of funds provided by them, and the activities carried out from these resources. The donors, therefore, could ignore the euro statements.

10. The dollar presentation of technical cooperation activities carried out under the Industrial Development Fund and trust funds required that the euro cash and investment balances as at 31 December 2002 amounting to €20.51 million (Industrial Development Fund: €4.92 million and trust funds: €15.59 million) be revalued to dollars at the United Nations operational rate of exchange in effect as at 31 December 2002. In view of the stronger euro and a United Nations system-wide decision to use the United Nations operational rate of exchange of January 2003 with an effective date of 31 December 2002 in order to provide more realistic information (normally the effective dates start from the beginning of the month, and the rate used would have been that made available on 1 December 2002—as compared to the December 2002 United Nations rate of exchange of €1=$1.0090 the rate to be applied as of 31 December was €1=$0.9580), this revaluation resulted in an unrealized gain of $2.86 million on the dollar statements. A significant part of this gain is attributed to not yet having the facility to manage technical cooperation activities in euros, particularly those funded by donors from within the euro zone. As stated in paragraph 8 above, with the upgrading of the financial

system later this year, the Secretariat should be able to manage such projects in euros with effect from January 2004.

11. This unrealized gain has, therefore, been shown on the financial statements as part of the accounts payable not distributable to donors on the grounds of prudence. The accounts payable will be cleared once the Secretariat has implemented the facility to manage projects in both euros and dollars. At that stage, donors which have funded activities in euros could disregard the dollar statements, as for these donors the euro statements would provide correct information about the status of funds provided by them and the activities carried out from those resources.

12. In order to further improve the accounting, all gains/losses resulting from the transactions are now being debited/credited to the relevant budget line on the project rather than to an exchange gain/loss account. For instance, a €10,000 obligation at the date of issuance, with the application of the United Nations rate of exchange, amounted to $10,100; however at the time of payment of €10,000, using the applicable United Nations rate of exchange on the date of payment, the payment in equivalent dollars amounted to $9,800, thus resulting in a gain of $300, which would be shown as a credit on the relevant budget line.

13. The governing bodies will be kept informed of further developments after upgrading of the system to allow management of technical cooperation activities in both dollars and euros, and the closure of the biennium 2002-2003 accounts, as well as discussions with the External Auditor.

II. ACTION REQUIRED OF THE COMMITTEE

14. The Committee may wish to consider recommending to the Board the adoption of the following draft decision:

"The Industrial Development Board:

"(a) Takes note of the information provided in document IDB.27/9-PBC.19/9 on the transition to a single currency system, and in particular regarding the preparation of the interim financial performance report for the biennium 2002-2003;

"(b) Notes with satisfaction the steps taken by the Director-General to ensure the implementation of the euro;

"(c) Requests the Director-General to inform Member States of further developments resulting from the closure of the biennium's accounts, as well as on the management of technical cooperation projects in both dollars and euros;

"(d) ...."